

Innovations

Impact of Accounting Practices on Financial Performances of SMEs in Somali Regional State of Ethiopia

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Abstract

The study was about the Impact of Accounting Practices on Financial Performance of SMEs in Somali Regional State, Ethiopia. The objectives of the study were: to study accounting practices adopted by SMEs and the second objective was to analyze whether financial performance was due to SME's use of accounting practices in Somali Regional State, Ethiopia. The study used descriptive research design with the primary data collected from 68 SMEs in in Somali Regional State by using structured questionnaires. Non- probability sampling was used. The study found that, that, 58.8 % disagreed that the SMEs have accountants. Most SMEs transactions were not endorsed by internal auditors as 66.2% disagreed. Also 86.8% disagreed that Management of SMEs use financial reports. The findings showed that, 50.0 % of SMEs disagreed that Profit earned by SMEs due to Auditing.60.3% respondents were disagreed that profits ascertainment is due to keeping books of accounts.48.5% disagreed that Contribution by auditors enhance financial Performance and 55.9% disagreed that management accounting enable profit generation in Somali Regional State, Ethiopia. This study recommended that, SME's laws be enhanced and made mandatory for SMEs to hire accountants and internal auditors or the government should have a pool of accountants who will be accountable for assisting SMEs in the use of accounting practices. The government should conduct workshops and seminars related to the use of accounting practices for SMEs/ owners. Policy makers should take necessary steps to bring faith among the SMEs that accounting practices will increase the profit of the SMEs in Somali Regional State, Ethiopia.

Key Words: 1.Accounting Practices, 2.Small and medium enterprises, 2.Financial Auditing, Management Accounting and Financial Performance

I. Introduction

In the developed countries such as United States, Britain, Japan and China, the use of accounting practices by SMEs has been well organized and well regulated. In Africa, the use of accounting practices has been hindered by various constrains such as lack of accounting skills by SMEs owners, lack of enough capital and ignorance on its help in the business enterprise. SMEs in Ethiopian are the major sources of job, income, significantly contribute to the local, regional and national GDP and key policies to eliminate poverty ((Hailai, Claire, Kibrom , Luback, Mahlet, NegasiHagos & Yemane, 2019)). There is a growing recognition about the roles of Small and Medium-Scale Enterprises (SMEs) in the economic growth and sustainable development of every nation (Ghartey, 1988; Moore, Petty, Palich& Longernecker, 2008). According to the report of World Bank (2015), the federal government of

Ethiopia has been given more priority to the SMEs and it is expecting that it will transform the country's economy in Growth and Transformation Plan/GTP. It is assumed that it will help and support different stakeholders such as financial service providers, technical and vocational educational institutions and different levels of government institutions. Thus, it is important for the developing countries to accelerate the growth of SMEs in order to achieve sustainable development. Accounting information is important for SMEs as it can help firms to manage their short-term problems in vital areas like costing, expenditure and cash flow by providing information to support, monitoring and control. As indicated by Nega and Hussien (2016) that banks and Micro Finance Institutions/MFIs in Ethiopia have poor accounting records by SMEs as one of the firm specific obstacles to provide credit to the SMEs. Thus, any issue that seems to hinder their performance should be investigated in order to solve the problem at potential stage. While, there are many factors that may lead to failure and non-performance of SMEs, this research opted to examine accounting practices because it is important for the management of business finances.

1.1 Statement of Problem

The performance of small and medium enterprises (SMEs) is said to be faced with myriad of constrains in developing countries as observed by Akande and Yunus (2013). SMEs have been played very important role in Africa for obtaining national development goals, such as poverty alleviation and economic growth (Mokaddem, 2006). According to study conducted by Onaolapo, & Adegbite, (2014) on the Analysis of the Impact of Accounting Records Keeping on the Performance of Small-Scale Enterprises and findings of the study was poor financial record keeping, low level of education, lack of knowledge, limited resources and inadequate trainings. A study done by Howard (2009) on Good Recording Important for Successful Busin Educess. Georgia: Angelo State University was also pointed out that the biggest problem for many small businesses was that they did not know where to start from with the business records so none were kept at all accounting records. Turyahebwa.A., Sunday.A. and Ssekajugo .D. (2013) highlighted that poor business performance has for long remained unexplained and it is especially in the third-world countries perspective where the Small and Medium Enterprises occupy the large part of the economy. Though, some studies conducted in developed nations such as Nguyen, (2001) cite inefficient financial management practices to contribute immensely to SMEs poor business performance. The government of Ethiopia has done a lot of efforts to create a suitable environment for growth of SMEs. Some of this effort includes enactment of laws for the creation of microfinance institutions and the introduction of entrepreneurship training courses in colleges and universities. Despite of that the government putting a lot of efforts to solve the problems of SMEs. But still, some of MSEs either making little profit or collapsing. This increases the doubt and raises the question "Could SMEs closure or making little profit is caused by underutilization of accounting practices?" This motivates the researcher to consider this study to assess the impact of accounting practices adopted by SMEs on financial performance of SMEs in Somali Regional State, Ethiopia.

1.2. Objective of the Study

The research objectives of this research are:

1. To study the accounting practices adopted by SMEs in Somali Regional State, Ethiopia.
2. To study financial performance of SMEs was due to use accounting practices in Somali Regional State, Ethiopia.

II Review of Related Literature

Mahfar & Omar (2004) According to him accounting forms an integral part of the management process in an organization, where it provides essential information to the business in its planning, evaluating, controlling and decision-making process.

Ismail & King (2005) The development of a sound accounting system in SME's depends on the owner-manager's level of accounting knowledge.

Reed (2010) According to him proper record keeping provides evidence of how the transactions were handled and substantiates the steps that were taken in order to comply with business standards.

John & Joshua (2011) Accounting records plays a critical role in the success or failure of contemporary business institutions. Accounting systems are responsible for recording, analysing, monitoring and evaluating the financial

condition of enterprises, preparation of documents necessary for tax purposes, providing information support to many other organizational functions

Padachi (2012) According to him without an accounting system, it would be very difficult for SMEs to determine performance, identify customer and supplier account balances and forecast future performance of the organization.

Nwobu (2015) According to him some of the benefits of employing accounting services include increased accountability of business operations, reduced fraud, correct measurement of profit and achievement of managements' set goals.

Musah (2017) told that the importance of proper record keeping and accounting by the SMEs in Ghana as allowing the businesses to make essential business decision; getting feedback after their action and making adjustment to the future and thus reduce operating costs and improve productivity and efficiency of the businesses.

Gawali and Gadekar (2017) has conducted a study that accounting and financial knowledge, competencies in interpreting the financial statements, owner-managers attitudes and their level of involvement in financial aspects of business largely responsible for the success or failure of MSM

Pavtar (2017) conducted a study and found that SMEs in Makurdi Metropolis keep sales & purchase day book and that SMEs in Makurdi Metropolis are faced with challenges of accounting practices and these challenges have a significant effect on their operations. It also recommended amongst others the need for Operators and management of SMEs to give more attention to proper financial record keeping and financial reporting procedures in SMEs as well as the need for government to consider enacting a legislation that will make preparation of financial report by all registered SMEs.

Mehari and Pasha Shaik (2017) carried out a study in Arba Minch town and Tigray region in Ethiopia respectively and concluded that accounting practices of SMEs are not structured and it is at low level to produce required information to both external and internal users for decision making purposes.

Israel and Emeakponuzo (2019) showed a strong linear relationship between accounting practices and performance by SMEs in Akwalbom State. It was therefore recommended that SMEs should endeavour to engage in accounting practices, such as cash and inventory management practices as well as preparation of financial statements, regardless of how simple it may appear. This study revealed that applying accounting practices are significant to the overall well-being of SMEs, yet the practices are still very low among those operating in Akwalbom State.

Kahsay and Zeleke (2019) have conducted a study and found that use of accounting records was poorly rated depicting that the management of SMEs did not invest in accounting services. Access to credit and capital did have positive relations but it is insignificant. Conversely, education and age had positive and significant relation.

Tseganesh (2019) has conducted a study and revealed that the accounting and reporting practices by the majority of the SMEs in Wolaita Sodo, Ethiopia was not in line with the basic assumptions such as economic entity assumption and accrual assumption and pointing out the major reason as lack of knowledge by the owner/ managers. For day to day recording of transactions, majority of the SMEs use the single-entry system. Majority of the SMEs considered that accounting is a means of complying with the requirement of the tax authority and rely on external consultants for the preparation of financial statements.

As far as the knowledge of the researcher is concerned, there had been no study conducted related to the impact of accounting practices on financial performances of SMEs in Somali Regional State, Ethiopia.

III. Research Design and Methodology

3.1. Description of the Study Area

The Somali Regional State (SRS) is a specific region which was chosen as a specific area of this research study. According to the 1994 Constitution, the state of SRS(Somali Regional State) is one of the 9 regional states of the Federal Democratic Republic of Ethiopia. The region has international boundary with the Somalia in the east and south, Kenya in the south west, Djibouti in the north east and is bordered by the Oromia region in the north and west, Afar in the north west. The region is divided into 11 zones and 93 warades and 1427 kebeles, (the lowest administration unit).

3.2. Research Design

This research used Descriptive research design. Structured questionnaires were used to collect data from the target population.

3.3. Target Population

The selected target population to achieve the objective of this study were small and Medium Sized business enterprise registered in Jigjiga city. According to the registration record, 673 SMEs are operating in different sectors in the city (Jigjiga city administration, office of MSME).

3.4. Sampling Technique & Sample Size

The sampling techniques used for the selection of the sample for the study was non-probabilistic sampling techniques. Researcher used non-probabilistic sampling techniques due to lack of resources and time constraint. 71 SMEs selected randomly for the study. The researcher has distributed 71 questionnaires among those 68 questionnaires were correctly managed and returned back but the remaining 3 questionnaire did not return. The response rate was 95.77%.

3.5. Source of Data Collection

The researcher used primary as well as secondary data. Primary data were collected by using closed and open-ended self-administered questionnaire and these were distributed to owners or managers of SMEs which were sampled. The secondary data that were used/reviewed include source of document, report and other written material available to the study from sampled SMEs

3.6. Data Analysis Method

After data required for the study collected, further research procedure like processing and analysing of collected data were conducted using descriptive statistics with the help SPSS Version 20.

IV. Results and Discussion

Section A

Accounting practices adopted by SMEs in Somali Regional State (SRS), Ethiopia

First objective of the study was to study the accounting practices adopted by SMEs in Somali Regional State, Ethiopia. The study tried to find out the accounting practices adopted by SMEs in the region.

Presence of Accountants in SMEs

This study wanted to find the presence of accountant in SMEs to enable gauge if accounting practices were being carried out. Table 4.1 shows summary of the results.

Table 4.1: There are presence of accountants in SMEs

Variables	Frequency	Percent
Strongly Agree	3	4.4
Agree	9	13.2
Neutral	13	19.1
Disagree	40	58.8
Strongly Disagree	3	4.4
Total	68	100.0

Source: Primary Data and Author’s Computation

Table 4.1 shows that 40 respondents equal to 58.8 % disagreed that they have accountants. 13 respondents equal to 19.1% were neutral, 9 respondents equal to 13.2% agreed that they have accountants, 3 respondents equal to 4.4% strongly disagreed to having accountants in their SMEs and 3 respondents equal to 4.4% strongly agreed that their SMEs have accountants. Accountants are the custodian of the accounting practices. Keeping good track of accounting practices is vital for SMEs in Somali Regional State but this result showed that, most SMEs do not have accountants.

Whether SMEs outsource bookkeeping activities

The study assessed whether SMEs outsource their bookkeeping activities. Table 4.2 shows the summary of the results.

Table 4.2: SMEs are outsourcing bookkeeping activities

Variables	Frequency	Percent
Strongly Agree	4	5.9
Agree	16	23.5
Neutral	2	2.9
Disagree	12	17.6
Strongly Disagree	34	50.0
Total	68	100.0

Source: Primary Data and Author’s Computation

Table 4.2 shows that 34 respondents equal to 50.0% strongly disagreed that SMEs are outsourcing their bookkeeping activities, 16 respondents equal to 23.5% agreed, 12 respondents equal to 17.6% disagreed, 4 respondents equal to 5.9% strongly agreed and 2 respondents equal to 2.9% were neutral. By strongly disagreeing to this, means that the accounting practices of SMEs in Somali Regional State is not in practice.

SMEs yearly financial reporting

Analysis of SMEs financial reporting was done and table 4.3 shows summary of results

Table 4.3: SMEs are performing the function of financial reporting yearly

Variables	Frequency	Percent
Strongly Agree	10	14.7
Agree	18	26.5
Neutral	23	33.8
Disagree	10	14.7
Strongly Disagree	7	10.3
Total	68	100.0

Source: Primary Data and Author’s Computation

Table 4.3 shows 23 respondents equal to 33.8% of SMEs were neutral as to the accounting practices of yearly financial reporting.18 respondents equal to 26.5% agreed to the statement and 10 respondents equal to 14.7% strongly agree to the same statement. 7 respondents equal to 10.3% strongly disagreed and 10 respondents equal to 14.7% disagreed.

Regular financial reporting and tracking of SMEs net profit

Under this section the study tried to establish whether regular financial reporting has assisted in tracking SMEs net profit. Table 4.4 shows the results.

Table 4.4: Financial reporting and tracking of SMEs net profit are performing regularly

Variables	Frequency	Percent
Strongly Agree	19	27.9
Agree	25	36.8
Neutral	2	2.9
Disagree	11	16.2
Strongly Disagree	11	16.2
Total	68	100.0

Source: Primary Data and Author’s Computation

Table 4.4 shows that 25 respondents equal to 36.8% of the respondents agreed that frequent financial reporting helped them to track their net profit. 19 respondents equal to 27.9% strongly agreed, 11 respondents equal to 16.2% strongly disagree, 11 respondents equal to 16.2% disagreed and 2 respondents equal to 2.9 % were neutral.

Transactions endorsement by Internal auditors

The study tried to find out if transactions were endorsed by internal auditors. Table 4.5 shows the summary.

Table 4.5: Transactions are endorsed by internal auditors

Variables	Frequency	Percent
Strongly Agree	2	2.9
Agree	9	13.2
Neutral	1	1.5
Disagree	45	66.2
Strongly Disagree	11	16.2
Total	68	100.0

Source: Primary Data and Author’s Computation

Table 4.5 shows that, most SMEs transactions were not endorsed by internal auditors. This is why 45 respondents equal to 66.2% disagreed, 11 respondents equal to 16.2% strongly disagreed, 9 respondents equal to 13.2% agreed 1 respondent equal to 1.5 % were neutral and 2 respondents equal to 2.9% strongly agreed. By disagreeing by 66.2%, it shows that there is a lack of internal auditors within SMEs to endorse their transactions; a situation where irregularity is bound to take place and profits ascertained may not be exact. The results of this study are all most same as the result of Mpoma (2017) who concluded that most transactions by SMEs were not endorsed by internal auditors since the majority of SMEs lacked internal auditors.

Internal Auditing Section in SMEs

In Table 4.6, the study looked at SMEs whether they have internal auditing section in their entity.

Table 4.6: There are internal auditing section in SMEs

Variables	Frequency	Percent
Strongly Agree	11	16.2
Agree	11	16.2
Neutral	2	2.9
Disagree	42	61.8
Strongly Disagree	2	2.9
Total	68	100.0

Source: Primary Data and Author’s Computation

Table 4.6 shows that 42 respondents equal to 61.8% disagreed that they have internal audit section. 11 respondents equal to 16.2% strongly agreed, 11 respondents equal to 16.2% agreed and 2 respondents equal to 2.4% were both neutral and strongly disagreed respectively. This means that SMEs have not aware of the importance of internal audit as one of the accounting practices.

Whether SMEs use external auditors

Large stakeholders of accounting information view that a report to be relied on is that which was audited by external auditors. Table 4.7 shows the result if the reports are audited by external auditors.

Table 4.7: SMEs are using external auditors

Variables	Frequency	Percent
Strongly Agree	5	7.4
Agree	11	16.2
Neutral	3	4.4
Disagree	41	60.3
Strongly Disagree	8	11.8
Total	68	100.0

Source: Primary Data and Author’s Computation

Table 4.7 shows that 41 respondents which equals to 60.3% disagreed SMEs prepare financial statements and are audited by external auditor. 11 respondents equal to 16.2% agreed that their financial statements are audited by external auditors, 5 respondents equal to 7.4% Strongly agreed, 8 respondents equal to 11.8% strongly disagreed and 3 respondents equal to 4.4% were neutral. It is a clear from the result that there was no accounting practice in place. This result also different from the findings of Rathnasiri (2014) who concluded that SMEs pay more attention in the preparation and monitoring of three elements of financial statements which are statement of profit and loss account, balance sheet and cash flow statement.

Budget preparation by SMEs

Budget is one of the elements of Management accounting practices. The study looked into whether the budget preparation practices is conducted by SMEs. Table 4.8 shows the results.

Table 4.8: SME prepare Budgets

Variables	Frequency	Percent
Strongly Agree	10	14.7
Agree	23	33.8
Neutral	3	4.4
Disagree	23	33.8
Strongly Disagree	9	13.2
Total	68	100.0

Source: Primary Data and Author’s Computation

Table 4.8 shows that, 23 respondents equal to 33.8% disagreed that they prepare budgets for Sales, production and Cash, 23 respondents equal to 33.8% agreed. 10 respondents equal to 14.7% strongly agreed and 9 respondents equal to 13.2% strongly disagreed while 3 respondents equal to 4.4% were neutral. The results support the findings of Maduekwe and Kamala (2016) who stated that budgets were perceived to be effective but the lack of top management support and qualified personnel were the main issues that prevent SMEs from using the budgets. Mwanza and Benedict (2018) also concluded that majority of SMEs do not prepare any kind of budgets.

Management use of financial reports

This segment of the study assessed whether management of SMEs uses various types financial reports frequently for their day today running of SMEs.

Table 4.9: Management of SMEs use financial reports

Variables	Frequency	Percent
Strongly Agree	2	2.9
Agree	2	2.9
Neutral	4	5.9
Disagree	59	86.8
Strongly Disagree	1	1.5
Total	68	100.0

Source: Primary Data and Author’s Computation

Table 4.9 shows that, 59 respondents equal to 86.8% disagreed that management use financial report. 4 respondents equal to 5.9% were neutral, 1 respondent equal to 1.5% strongly disagreed and 2 respondents equal to 2.9% agreed. This result differs from the notion stated by Rathnasiri (2014) that management’s understanding of the financial information could be correlated with business success on one hand or the resistance to failure on the other.

Section B

Financial Performance is due to SME’s use of Accounting Practices

Respondents’ response on the issue whether profit was earned due to auditing practices in the region. In this segment, the study looked at what enable the SMEs to earn profits. The study tried to establish whether profits earned were a result of accounting (auditing) practices of the SMEs.

Table 4.10: Profit earned by SMEs due to Auditing

Variables	Frequency	Percent
Strongly Agree	15	22.1
Agree	12	17.6
Neutral	2	2.9
Disagree	34	50.0
Strongly Disagree	5	7.4
Total	68	100.0

Source: Primary Data and Author’s Computation

Table 4.10 shows that, 34 respondents equal to 50.0% disagreed that profit was earned due to auditing. 15 respondents equal to 22.1% strongly agreed, 12 respondents equal to 17.6% agreed, 5 respondents equal to 7.4% strongly disagreed and 2 respondents equal to 2.9% were neutral. The results of this study are differed from findings of Karunananda and Jayamaha (2011) who stated that there was significant positive correlation between the financial auditing and the enterprises’ performance within SMEs in Sri Lanka. This can be concluded that audited financial report are essential to ascertain profit that can be accepted by the different users of the same information.

Profits ascertainment was due to keeping books of Accounts

The study looked into whether profits earned were from keeping of the books of accounts. Table 4.11 shows the results.

Table 4.11: Profits ascertainment is due to keeping books of accounts

Variables	Frequency	Percent
Strongly Agree	12	17.6
Agree	11	16.2
Neutral	3	4.4
Disagree	41	60.3
Strongly Disagree	1	1.5
Total	68	100.0

Source: Primary Data and Author’s Computation

Table 4.11 shows that, 41 respondents equal to 60.3% of SMEs in Somali Regional State disagreed and 1 respondent equal to 1.5% strongly disagreed that profit due to keeping books of accounts. 17.6% strongly agreed, 16.2% agreed and 4.4% were neutral. Results also supports the findings of Mutua (2015) who concluded that SMEs do not maintain complete accounting records due to of lack of accounting knowledge and the cost of hiring professional accountants. He also stated that there is inefficient use of accounting information to support financial performance measurement by SMEs. It made very difficult for the entrepreneurs to calculate their business profit efficiently.

Contribution by auditors enhanced financial Performance

Auditing is the most essential accounting practices to show the financial performance of SMEs. In this part, the study depicted the contribution by auditors to good performance in Somali Regional State.

Table 4.12: Contribution by auditors enhance financial Performance

Variables	Frequency	Percent
Strongly Agree	5	7.4
Agree	12	17.6
Neutral	2	2.9
Disagree	33	48.5
Strongly Disagree	16	23.5
Total	68	100.0

Source: Primary Data and Author’s Computation

Table 4.12 shows that 33 respondents equal to 48.5% disagreed that contribution by auditors enhanced financial performance of their business. 16 respondents equal to 23.5% strongly disagreed, 12 respondents equal to 17.6% agreed, 5 respondents equal to 7.4% strongly agreed to the statement and 2 respondents equal to 2.9% were neutral. As previous result shows that there are no internal audit sections and there was no endorsement of transactions by internal auditors. This result also supports the findings of Olasupo et al (2016) who concluded that there were several of enterprises (SMEs) prematurely die, before they can achieve their objectives due to poor management arising from weak, inadequate, undependable accounting and financial information as well as lack of regular auditing and risk assessment practices.

Management Accounting enabled profit generation

In this segment, the study looked at the frequency at which management follow up the profit generated. Table 4.13 shows the results.

Table 4.13: Management Accounting enable profit generation

Variables	Frequency	Percent
Strongly Agree	2	2.9
Agree	1	1.5
Neutral	10	14.7
Disagree	38	55.9
Strongly Disagree	17	25.0
Total	68	100.0

Source: Primary Data and Author’s Computation

Table 4.13 shows that, 38 respondents equal to 55.9 % of SMEs in Somali Regional State disagreed that Management Accounting enabled profit generation. 17 respondents equal to 25.0% strongly disagree, 10 respondents equal to 14.7% were neutral, 1 respondent equal to 1.5% agreed and 2 respondents equal to 2.9% strongly agreed.

V. Conclusion

The conclusions have been drawn on the basis of the findings of the study. It is based on each of the study objective. The study concluded that SMEs in Somali Regional State didn’t use accounting practices to run their SMEs. These results were consistent with results of Matovu (2005) who found that small and medium enterprises did not use accounting practices in Ghana and thus their profit margin was low. The study also concluded that SME’s performance was low which the study attributed for not using accounting practices.

Recommendations

SME’s laws be enhanced and made mandatory for SMEs to hire accountants and internal auditors or the government to have a pool of accountants responsible for assisting SMEs in the use of accounting practices. Also, the study recommends that budgets for SMEs should be lodged or submitted to the authority concerned which will monitor the quarterly report and advice where possible on use of accounting practices. The government should conduct workshops and seminars for concerning the use of accounting best practices for SMEs/ owners. Concerned authority should take necessary confidence measures so that SMEs/owner should started to believe that accounting practices will increase the profit of the SMEs.

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